U.S. Senate
Republican Policy
Committee

Legislative Notice

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H.R. 8 – Death Tax Repeal Permanency Act of 2005

Calendar No. 84

The House of Representatives passed H.R. 8 on April 13, 2005, by a vote of 272 to 162; on April 20, 2005, it was read a second time and placed on the Senate Calendar.

NOTEWORTHY

- It is anticipated that on Tuesday, June 6, the Majority Leader will file a cloture petition on the motion to proceed to H.R. 8, the "Death Tax Repeal Permanency Act of 2005," which passed the House of Representatives in April 2005. As such, the Senate would vote on the cloture motion on Thursday, June 8.
- In 2001, Congress enacted a phaseout of the federal estate or "death" tax, with its complete repeal scheduled to occur in 2010. Due to Democrat opposition to the 2001 tax-relief bill in general, the repeal will only be temporary; the tax springs back to life in 2011 with a 55 percent tax rate and only a $1 million exemption amount.
- The debate over repeal of the death tax too often focuses only on the taxes that decedents' estates *actually pay*. Such a limited focus, however, ignores the real costs that this tax imposes on Americans, especially owners of small businesses and farms, including lifetime estate-planning costs, compliance costs at death, and deadweight costs (e.g., adverse influences on individuals' economic decision making).
- The result of these costs is an enormous loss of economic opportunity. With the repeal of the death tax, studies have shown that substantial capital would be channeled back into the economy, fueling investment, employment, and overall economic growth.
- Studies have also confirmed that the permanent repeal of the death tax would have a dynamic effect on the economy, producing an *increase* in federal tax revenues.

Background

The following background materials are based on the Republican Policy Committee's paper, "The Death Tax: An Economic Case for Permanent Repeal," released on June 13, 2005 – http://rpc.senate.gov/_files/Jun1305DeathTaxMW.pdf.

As part of the Economic Growth and Tax Relief Reconciliation Act of 2001, Congress enacted a phaseout of the federal estate or "death" tax, with its complete repeal in 2010.[1] At the insistence of Senate Democrats, however, the application of the 2001 tax cuts was limited to 10 years.[2] As Figure 1 illustrates, the 10-year life of the statute produced a complex set of tax rules with respect to the death tax – rules that change *every year* until 2011.

Figure 1

Major Provisions of the Death Tax
2006 through 2011

Year	Individual Exemption Amount	Highest Tax Rate	Basis Rule
2006	$2 million	46 percent	Stepped-up basis at death*
2007		45 percent	
2008			
2009	$3.5 million		
2010	Death tax repealed	Death tax repealed	Stepped-up basis for up to $1.3 million of assets per person; carry-over basis for the balance of the estate**
2011 and later	$1 million	55 percent	Stepped-up basis at death*

*Under the stepped-up basis rule, the cost basis of an asset generally is increased to the fair market-value on the date of the decedent's death.
**Under the carry-over basis rule, the cost basis of an asset generally would be the price paid by the decedent when the asset was originally purchased.
Source: Internal Revenue Code

Despite the complexity of current law, recent polls continue to show that a majority of Americans support repeal of the death tax, even though most individuals believe they will not

[1]Title V of H.R. 1836, 107th Congress, 1st Session, Public Law 107-16, June 7, 2001.
[2]Section 901 of Public Law 107-16.

end up paying it.[3] Support is particularly strong among women and minorities, whose ownership of small businesses in the United States has grown rapidly in recent years.[4] Advocates of repealing the death tax argue that it unfairly hinders Americans' ability to build family wealth, deprives small businesses of valuable capital, and ultimately retards economic growth.[5]

While the repeal of the death tax in 2010 was a significant moral and economic victory for Republicans, the full economic potential of repealing the death tax will only be achieved when Congress makes it permanent. For its part, the House of Representatives passed H.R. 8, the "Death Tax Repeal Permanency Act of 2005," on April 13, 2005, by a vote of 272 to 162. That bill would make permanent the repeal of the death tax in 2010 under current law.

The Real Burden of the Death Tax

The debate over repeal of the death tax has too often focused only on the taxes that decedents' estates actually pay. While death-tax revenues are relatively small – $24.8 billion in 2005 and have averaged 1.3 percent of federal revenues annually over the past 10 years – proponents continue to view the tax as a fertile revenue source.[6] They argue that "most Americans never have to think about the estate tax, let alone worry about it . . ." because only large estates *actually pay* death taxes.[7] By focusing only on the taxes paid, however, they ignore the real costs that this tax imposes on Americans, especially owners of small businesses and farms, and on the nation's economy.

Lifetime Planning Costs

A primary reason for the low level of federal death-tax revenues is that Americans spend an inordinate amount of time and money *to avoid* leaving an estate that would be subject to the tax. While individuals will continue to provide instructions for the transfer of their estates to family members, friends, and charities, the threat of the death tax substantially increases the complexity of estate plans, requiring time and money that cannot be invested in productive economic activities. Moreover, the current law's phaseout, repeal, and resurrection of the death

[3] Frank Luntz and Jef Pollack, "Americans Talk Taxes," The Luntz Research Companies, March 2, 2005 ("64 percent [of Americans] want to abolish the Death Tax, while only 31 percent want it maintained in its current form"; Even when respondents knew that the tax only affects estates of $1.5 million or more, 60 percent want to see it reduced, while only 34 percent want to see it maintained in its current form); Tax Foundation, "Tax Foundation Annual Survey of U.S. Attitudes on Tax and Wealth," April 14, 2005 – http://www.taxfoundation.org/publications/show/342.html (68 percent of survey respondents favored elimination of the death tax).

[4] Women Impacting Public Policy (WIPP), "Results of National Poll of Women Impacting Public Policy Members," February 11, 2004 (81 percent of respondents indicated they would vote for a candidate who would support the elimination of the death tax, while 15 percent said they would support a candidate who would vote to keep the tax); Impacto Group, LLC, "Summary Report of Five-State Executive Interview Study of 100+ Hispanic Family-Owned Businesses on Federal 'Death Taxes,'" June 1, 2004, p. B4 (71 percent of Hispanic family-owned businesses "would vote for someone who argued 'death taxes' should be eliminated, over a candidate who believes that the tax is fair because it targets only the rich.")

[5] Policy and Taxation Group, "Reasons to Eliminate the Federal Estate Tax" – http://www.policyandtaxationgroup.com/html/repeal.html#reasons.

[6] Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2007, Historical Tables*, Tables 2.1 and 2.5.

[7] "Long Live the Estate Tax," *New York Times*, April 15, 2005.

tax has only exaggerated this situation. As a result, individuals effectively must have three estate plans:

- A plan covering 2006 through 2009 that minimizes the tax burden on the estate in an environment of declining death-tax rates, increasing exemption amounts, and stepped-up basis for assets transferred to heirs;

- A second estate plan for 2010 alone when the tax is repealed and modified basis-step-up and carryover-basis rules become effective; and

- A third plan in the event the individual dies in 2011 or later when the death tax is resurrected with a top rate of 55 percent and a $1 million exemption amount.[8]

At a minimum, estate plans require basic documents such as wills and powers of attorney. When a business or farm is part of the estate, however, the complexity of the estate plan increases dramatically. Often these plans involve the formation of complex trusts, limited partnerships, and other arrangements for the transfer of the business to the owner's children or other family members during the owner's life and finally upon his death. Complex arrangements can also involve the creation of Employee Stock Ownership Plans to facilitate the transfer of a business to family and non-family employees.

Estate planning also frequently involves detailed gift programs to take advantage of the provision under current law that allows individuals to make limited transfers during their lifetime (i.e., up to $12,000 in 2006) to anyone on a tax-free basis.[9] And, complex charitable-giving trusts are often established for individuals who wish to leave assets to charities while providing some income to family members for a limited period of time.

Regardless of their structure, estate plans generally involve substantial fees for legal, accounting, and financial-planning services. As illustrated in Figure 2 (on page 6), basic planning documents can cost as much as $50,000, while plans involving limited partnerships can cost up to $250,000. In addition, when a plan involves a separate taxable entity, such as a trust or limited partnership, additional *annual* fees are usually incurred to comply with annual tax reporting requirements.[10]

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[8]Sections 1014, 1022, 2001, and 2010 of the Internal Revenue Code (IRC) (26 U.S.C. *et seq.*).

[9]IRC § 2503.

[10]For example, trusts are generally required to report their taxable income to the Internal Revenue Service (IRS) on Form 1041, and limited partnerships are required to file Form 1065. In both cases, related schedules – e.g., Schedule K-1 – must be prepared for each beneficiary or partner and filed with the IRS.

Figure 2

Frequently Used Estate-Planning Techniques and Their Costs

Estate-Planning Technique	Description	Range of Fees
Basic estate-planning documents	Generally include wills, powers of attorney, and living trusts	$1,000 - $50,000
Basic trusts	Established to transfer assets to children and spouses in order to reduce the value of an estate	$50 - $10,000
Retirement-benefit planning	Used to minimize the income and estate tax liability for tax-deferred retirement plans, such as 401(k) accounts	$500 - $50,000
Irrevocable life insurance trusts	Created to remove life insurance policies from being taxed as part of an estate	$1,000 - $15,000
Family limited partnerships and limited liability companies (LLCs)	Established to transfer ownership interests in a family business to subsequent generations and to reduce the value of the estate's interest in the business	$5,000 - $250,000
Planning for the disposition of a closely held business	In addition to limited partnerships and LLCs, other advanced planning techniques, such as stock redemption plans, S corporations, and Employee Stock Ownership Plans, can be used to transfer a business to family members or employees	$5,000 - $1,000,000
Charitable trusts	Created to reduce the value of an estate by taking advantage of the deduction for gifts to charity while providing income to heirs for a limited time	$2,500 - $50,000

Source: Planning techniques and cost estimates prepared by the law firm of Schiff Hardin LLP, Chicago, Illinois, for the Policy and Taxation Group, January 2005.

In many cases, estate plans also involve life insurance to provide funds in the event that the estate is subject to the death tax. For owners of small businesses and farms, such insurance is particularly important since the business often represents the majority of their estates.[11] Absent insurance, a death-tax liability could require the sale of business assets and threaten the continued operation of the enterprise. Moreover, life insurance for older Americans can be very costly, depending on their health and other factors. For instance, small business owners have reported spending $50,000 to $70,000 per year in life-insurance premiums in order to ensure that the death tax did not jeopardize the business.[12]

While beneficiaries are not subject to tax on life-insurance proceeds they receive, the value of an insurance policy that was purchased by a decedent is generally included in his estate

[11]Joint Economic Committee (JEC), "The Economics of the Estate Tax: An Update," June 2003, p. 8 – http://www.house.gov/jec/tax/06-18-03.pdf; William W. Beach, "Time to Repeal Federal Death Taxes: The Nightmare of the American Dream," Heritage Foundation, *Backgrounder*, No. 1428, April 4, 2001, p. 13 – http://www.heritage.org/Research/Taxes/BG1428.cfm.

[12]National Federation of Independent Business, "Issues in the News: The Summit for Permanent Death-Tax Repeal," May 10, 2005 – http://www.nfib.com/object/IO_22148.html; Brian Gloe, in testimony before the Senate Committee on Small Business, April 12, 1999, p. 16.

for purposes of calculating the death tax. To avoid that result, a separate trust must be created to purchase the insurance policy and pay the annual premiums. That step entails additional professional expenses, and, as illustrated in Figure 2, it can increase an individual's overall estate-planning costs by as much as $15,000.

In most cases, the bulk of estate-planning costs occurs when the plan is created and the corresponding trusts or other arrangements are established. According to one survey, an average family can spend $30,000 to $150,000 on such planning, while another survey concluded that family-owned businesses in New York can spend an *average* of $125,000 on estate planning.[13] However, estate plans must be periodically reviewed and revised, especially in light of the repeated statutory changes that have occurred in recent years, and annual expenses also exist, particularly with respect to arrangements to protect small businesses. In short, estate-planning expenses incurred to avoid the death tax are hardly discrete, insignificant costs.

Compliance Costs at Death

After a lifetime of estate-planning expenditures, successful individuals may still leave estates that will be subject to the death tax. At that point, substantial additional costs must be incurred to prepare and file a federal estate-tax return – Form 706 – with the Internal Revenue Service (IRS).[14] This three-page form, with 22 schedules and worksheets that may apply depending on the circumstances, is a testament to the enormous complexity of the death tax.[15]

While the IRS estimates the average time required to locate the necessary records, learn about the law, prepare the form, and file the return is just under 38 hours,[16] executors generally turn to lawyers and accountants who specialize in death taxes to prepare the return.[17] Tax-preparation fees can range from $5,000 to $50,000, according to estimates,[18] with substantially higher expenses for complex estates and when a controversy arises with the IRS.[19] In addition, professional appraisers are frequently required since the estate-tax return must reflect the fair-market value of all the estate's property. While appraisals for residential property can be a few hundred dollars, the cost of valuing a small or medium-sized business can range from $7,500 to

[13] American International Automobile Dealers Survey, May 2003, as reported by Bruce Bartlett in "The Case Against the Death Tax," April 12, 2004 – www.aiada.org/article.asp?id=8919; Travis Research Associates, "Survey of the Impact of the Federal Estate Tax on Family Business Employment Levels in Upstate New York," Public Policy Institute of New York State, 1999.

[14] Additional returns may be required for estates qualifying for special treatment of small businesses (Form 706D), estates subject to the generation-skipping tax (Form 706GS), and estates that include qualified domestic trusts (Form 706QDT).

[15] Form 706,"United States Estate (and Generation-Skipping Transfer) Tax Return," 2005 – http://www.irs.gov/pub/irs-pdf/f706.pdf.

[16] Form 706 Instructions, p. 27.

[17] A survey by the Padgett Foundation found that the majority of small business accountants do not handle preparation of estate-tax returns themselves and prefer to refer such matters to specialists. Padgett Business Services Foundation, "Estate Planning (Form 706) Survey," Spring 2005.

[18] Estimates prepared by the law firm of Schiff Hardin LLP, Chicago, Illinois, for the Policy and Taxation Group, June 2005.

[19] In cases in which an estate-tax return becomes involved in litigation, fees for legal and other professional services can increase exponentially.

$50,000, and it can be even more for businesses in special industries or companies with complex business structures.[20]

It is also important to note that compliance costs are not limited to estates that owe the death tax. The filing threshold for an estate-tax return is based on the "gross" estate. Allowable deductions, such as debts, bequests to a surviving spouse, and charitable contributions, are not counted for purposes of determining whether an estate-tax return must be filed. For example, if an individual dies in 2006 owning a home, retirement savings, and other assets with a fair-market value of more than $2 million, his estate will be required to file a return and incur the related compliance costs. However, on the tax return, the mortgage on the decedent's home may be deducted along with the value of any property he leaves to his spouse or charity, which may result in a zero tax liability.

The most recent data from the IRS underscores this point. In 2004, there were 62,718 estate-tax returns filed, but only 30,276 owed any taxes to the federal government.[21] In short, 52 percent of estates filing a return were required to incur sizeable legal, accounting, and other professional expenses simply to provide the government with several dozen pieces of paper, but no tax payment was required.

Regardless of whether an estate owes death taxes or not, current law requires that estate-tax returns must generally be filed within nine months of the date of death.[22] That deadline can make it difficult for estates to raise the cash necessary to pay for compliance expenses (and any taxes due) in a timely manner. As a result, estates may be forced into economically undesirable sales of assets to meet cash-flow demands. Or, they may be required to borrow such funds, adding interest expenses to the already burdensome compliance costs. When a small business is involved, the cash-flow constraints can be particularly devastating, since most small firms are undercapitalized and the sales of business assets to pay for death-tax compliance costs can easily jeopardize the continuation of the business.[23]

When added to amounts spent on estate planning, compliance costs represent an enormous and unnecessary waste of Americans' lifetime savings. *By one estimate, the amount spent on avoiding the death tax is approximately equal to the amount of tax revenue generated* – from any perspective, that is hardly an efficient result for a tax system.[24]

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[20]Michele Miles, Executive Director, Institute of Business Appraisers, in correspondence with the author, June 3, 2005; Peter Barash representing the American Society of Appraisers, in correspondence with the author, June 6, 2005; see also, Steven F. Schroeder, "How Much Should a Business Appraisal Cost?" Inc.com, July 2003 – http://www.inc.com/articles/2003/07/25684.html.

[21] IRS, Statistics of Income Division, "Table 1 – Estate Tax Returns Filed in 2003: Gross Estate by Type of Property, Deductions, Taxable Estate, Estate Tax, and Tax Credits, by Size of Gross Estate," unpublished data, October 2004, available at: http://www.irs.gov/pub/irs-soi/04es01tc.xls.

[22]IRC § 6075(a). Estates may also request a six-month extension for filing the return, and the IRS may grant a limited extension for payment of estate taxes, subject to interest. IRC §§ 6081 & 6161; IRS Form 4768, "Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes."

[23]Bartlett, p. 3.

[24]Henry J. Aaron and Alicia H. Munnell, "Reassessing the Role for Wealth Transfer Taxes," *National Tax Journal*, Vol. 45, No. 2, June 1992, p. 139. Other studies have found that taxpayers spend at least $0.30 to avoid the death tax for every dollar that the federal government collects. Richard F. Fullenbaum and Mariana A. McNeill,

Deadweight Costs

The death tax also adversely influences individuals' economic decision making, acting as a deadweight or deterrent to productive behavior like saving, investing, and entrepreneurship. As evidenced by the enormous amounts spent on estate planning, Americans go to extraordinary ends to avoid the moral and economic implications of the death tax. Such efforts generally focus on the consumption or disposition of assets – to pay for estate planning, to purchase a higher quality of retirement life, or to give assets away to family, friends, or charities – all to reduce the size of the estate that would be subject to as much as 47 percent in death taxes today.[25]

Hence, the death tax encourages individuals to consume their assets rather than save them. The result is a diminished supply of investment capital – a reduction of $847 billion by one estimate.[26] Moreover, as the supply of capital decreases, the cost of the capital that is available rises.[27] Studies have estimated that the consumption bias of the death tax adds between 1 percent and 3 percent to the effective tax burden on capital – a significant additional cost.[28] For small business owners, in particular, the diminished availability of capital and its increased costs make it more difficult for them to raise funds necessary to make investments in new equipment, which would increase productivity, and to support new and better paying jobs.[29]

The death tax also discourages individuals from participating in the workforce.[30] By continuing to work, an older individual will continue earning income that will add to his estate. Alternatively, an individual who chooses retirement will begin consuming his savings, resulting in a smaller estate. For the small business owner approaching retirement age, the death tax creates a conundrum: Why continue building a successful business only to have it dismantled at death to pay taxes?[31] Given the tax's destructive impact, it is not surprising that less than 30 percent of small businesses survive to a second generation of ownership and only about 13 percent continue to a third generation.[32]

More broadly, the economy is adversely affected when the death tax encourages older workers to choose retirement over continued employment. Over the next decade, as the baby-

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"The Effects of the Federal Estate and Gift Tax on the Aggregate Economy," Research Institute for Small and Emerging Business, *Working Paper Series* No. 98–01, 1998, p. 11.

[25]JEC, "The Economics of the Estate Tax: An Update," p. 6; IRC § 2001.

[26]JEC, "Costs and Consequences of the Federal Estate Tax," May 2006, p. 19 – http://www.house.gov/jec/publications/109/05-01-06estatetax.pdf.

[27]Aldona Robbins and Gary Robbins, "The Case for Burying the Estate Tax," Institute for Policy Innovation, March 15, 1999, p. 15 – http://www.ipi.org/; N. Gregory Mankiw, "CEA Chairman N. Gregory Mankiw Makes the Case for Estate Tax Repeal," Center for Policy Research, Special Report, December 2003, p. 2 – http://www.accf.org/pdf/ SR1203.PDF.

[28]James M. Poterba, "Estate Tax and After-Tax Investment Returns," *Does Atlas Shrug?*, Joel M. Slemrod, ed., Harvard University Press, 2000, p. 339; Beach, "Time to Repeal Federal Death Taxes: The Nightmare of the American Dream," p. 17.

[29]Beach, p. 13.

[30]Fullenbaum & McNeill, p. 10; Beach, p. 22.

[31]A survey of women business owners found that half of the respondents have or would consider selling their businesses rather than risk having their children inherit the enterprise only to sell it to pay the death tax. WIPP, "Results of National Poll of Women Impacting Public Policy Members," February 11, 2004.

[32]Small Business Administration, Office of Advocacy, "1995 White House Conference on Small Business Issue Handbook," 1995.

boom generation begins to retire and is succeeded by a significantly smaller generation, research projects a sizeable labor shortage – of more than 6 million qualified workers by 2012, increasing to 35 million workers by 2030.[33] For many employers, this pending demographic shift threatens to result in the loss of experienced, skilled employees. The resulting "brain drain" could have a negative impact on productivity and economic growth in U.S. industries if older workers leave the workforce entirely.[34]

Lost Economic Opportunities

Collectively, these costs – planning, compliance, deadweight, and death taxes – represent an enormous loss of economic opportunity for the nation's economy. If the death tax were repealed, studies have demonstrated that substantial capital would be channeled back into the economy, fueling investment, employment, and overall economic growth. According to a study conducted in 2002 by Alfredo Goyburu using econometric modeling, the permanent elimination of the death tax beginning in 2003, rather than in 2010 as provided by current law, would produce the following economic results:

- ***Increased Investment Capital***: available non-residential investment capital would have increased by $25.1 billion, and the cost of capital would drop by 0.3 percent.

- ***Higher Employment***: an average of 104,000 more jobs would have been created annually.

- ***Greater Disposable Personal Income***: disposable income for American workers would have increased by an average of $10.3 billion per year.

- ***Stronger Economic Growth***: overall, average growth in Gross Domestic Product would have increased by $10.6 billion without the death tax.[35]

These results are consistent with other econometric studies that have assessed the likely impact of repealing the death tax.[36] In fact, in terms of job-creation potential alone, recent estimates by the Heritage Foundation indicate that repeal could produce between 170,000 and

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[33]Employment Policy Foundation, "Phased Retirement: Its Time has Come," *The Balancing Act*, April 15, 2003, pp. 1-2 – http://www.epf.org/ pubs/newsletters/2003/ba20030415.pdf.

[34]Barbara D. Bovbjerg, Director of Education, Workforce, and Income Security, Government Accountability Office, in testimony before the Senate Special Committee on Aging, April 27, 2005, p. 7 – http://www.gao.gov/ new.items/d05620t.pdf. See also the Senate Republican Policy Committee's paper on working in retirement: "Retirement-Income Security: Reducing the Disincentives for Working in Retirement," May 16, 2005 – http://rpc.senate.gov/_files/May1605RIRetireTaxMW.pdf.

[35]Alfredo B. Goyburu, "The Economic and Fiscal Effects of Repealing the Federal Estate, Gift, and Generation-Skipping Taxes," Center for Data Analysis, Heritage Foundation, Report #02-08, November 15, 2002, pp. 7-8 – http://www.heritage.org/Research/Taxes/CDA02-08.cfm.

[36]See e.g., Richard E. Wagner, "Federal Transfer Taxation: A Study in Social Cost," Institute for Research on the Economics of Taxation, *Fiscal Issues*, No. 8, 1993; William W. Beach, "The Case for Repealing the Estate Tax," Heritage Foundation, *Backgrounder*, No. 1091, August 21, 1996 – http://www.heritage.org/Research/Taxes/ BG1091.cfm; Fullenbaum & McNeill; and Robbins & Robbins.

250,000 more jobs per year[37] – the equivalent of at least an extra month of job growth, based on the employment figures reported over the past two years.[38]

Moreover, the economic results of the Goyburu study may underestimate the economic potential of repealing the death tax given the reduction and equalization of the dividend and capital-gains tax rate enacted in May 2003, after the study was concluded.[39] Those changes to the tax code alone reduced the cost of capital and provided a significant incentive for investment.[40] If the 2003 tax cuts were coupled with the permanent repeal of the death tax – thereby eliminating its bias against investment – there is likely to be an even greater incentive for investment than the Goyburu econometric model anticipated. As a result, the economic outcomes with respect to growth in employment, wages, and GDP could be even more significant.

In short, the survival of the death tax will continued to promote economically inefficient consumption by Americans seeking to reduce their ultimate tax burden. A permanent repeal, however, would produce dynamic results – channeling significant amounts spent on estate-planning and compliance into efficient investments and encouraging Americans to save and continue their entrepreneurial efforts, which together will fuel the current environment for job creation and economic growth.

The Cost Myth of Complete Repeal

Despite the demonstrable economic benefits, supporters of the death tax continue to object to a permanent repeal, regularly asserting that the "cost" to the government would be too great. As discussed above, it is misleading to overlook the planning, compliance, and deadweight costs when determining the impact of the death tax on the individual. It is equally misleading to view the "cost" of repealing the death tax simply in terms of the death-tax revenue that the federal government would no longer collect, usually referred to as the "static" revenue effect.

Beginning with the seminal work by Professor Richard Wagner in 1993, studies have confirmed that the permanent repeal of the death tax would have a dynamic effect on the economy, enhancing economic activity and producing an *increase* in federal tax revenues that would largely offset – or even exceed – the foregone revenues from the death tax.[41] Most recently, the Goyburu study (discussed above) indicates that, if the death tax had been repealed permanently beginning in 2003, the increase in federal tax revenues resulting from stronger economic growth would have exceeded the lost revenues from the death tax by $5.7 billion over

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[37] William W. Beach, "Now is (Still) the Time to Permanently Repeal Federal Death Taxes," Heritage Foundation, *WebMemo*, No. 720, April 12, 2005, p. 2 – http://www.heritage.org/Research/Taxes/wm720.cfm.

[38] According to the Bureau of Labor Statistics, more than 5 million new payroll jobs have been created since May 2003. BLS, "Employment Situation: April 2006," Table B-1 and historic tables, USDL 06-777, May 5, 2006 – http://www.bls.gov/news.release/pdf/empsit.pdf.

[39] H.R. 2, 108th Congress, 2d Session, Public Law 108-27, May 28, 2003.

[40] Council of Economic Advisors, *Economic Report of the President*, Feburary 2004, p. 45.

[41] Wagner, pp. 24-28; Fullenbaum & McNeill, p.18; Robbins, p. 20; Beach, "The Case for Repealing the Estate Tax," p. 29. See also, Mankiw, p. 2.

10 years.[42] And, with the changes to the dividend and capital-gains tax rates that were enacted after the study's completion, that net increase in revenues could be even more significant.[43]

A more recent study by Professors Wilbur Steger and Frederick Rueter examined the effect that permanent repeal would have on certain aspects of individual behavior, such as the timing of decisions to sell assets with built-in capital gains.[44] The study concluded that the repeal of the death tax would encourage individuals to enter into investment transactions for economic, rather than death-tax, reasons, which would unleash the built-in capital gains. As a result, the government would benefit from substantial income-tax revenues flowing from such transactions. In fact, the study concluded that the increased income-tax revenues would offset the lost estate-tax revenues, producing a $1.7 billion surplus over 10 years if the death tax were repealed in 2005.[45]

While the conclusions reached by the Steger and Rueter study are significant, it is noteworthy that the computer model on which it was based only focuses on a narrow set of individual investment behavior. Importantly, the study does not take into account the dynamic effect that death-tax repeal would have on planning and compliance costs. Incorporating the increased capital that would be generated by reducing these inefficient expenditures should expand economic activity and *increase* tax revenues even further.[46]

The risk of relying solely on static revenue estimates can also be seen in the context of another recent change in tax policy – the reduction in capital-gains tax rates that has occurred twice in the last 10 years. Like the death tax, capital-gains taxes are relatively easy to minimize since the owner of a capital asset can choose when to sell the asset. In 1997, the capital-gains tax rate was reduced from 28 percent to 20 percent.[47] At that time, the Joint Committee on Taxation (JCT) estimated that the 1997 reduction would result in a revenue loss of $21.2 billion over 10 years.[48] Despite that static revenue estimate, the reduced capital-gains tax rate produced dynamic effects on the economy. Looking at the actual results from just the first four years of the rate reduction,[49] capital-gains tax revenues increased by $47.8 billion more than the revenue changes estimated by the JCT.[50]

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[42]Goyburu, p. 8.

[43]See footnote 39 and accompanying text.

[44]Wilber A. Steger, Ph.D. and Frederick H. Rueter, Ph.D., "The Revenue Effects of Estate Tax Repeal and Basis Step-Up Limits," *Tax Notes Today*, 2005 TNT 108-22, May 18, 2005.

[45]Steger & Reuter, p. 4. In reaching the surplus conclusion, the study assumes that current law will remain unchanged with respect to the capital-gains tax rate, and the rate will revert to a 20-percent level after 2008 when the current 15-percent rate is scheduled to expire. Public Law 108-27, § 303. If the 15-percent capital-gains rate is extended through the study's 10-year horizon, the income-tax revenues would not completely offset the loss of estate-tax revenues (i.e., a $42.36 billion shortage would result). Steger & Reuter, Table 2.

[46]Steger & Reuter, pp. 4-5.

[47]Section 311 of the Taxpayer Relief Act of 1997, H.R. 2014, 105th Congress, 1st Session, Public Law 105-34, August 5, 1997.

[48]JCT, "Estimated Budget Effects of the Conference Agreement on the Revenue Provisions of H.R. 2014, the 'Taxpayer Relief Act of 1997,'" JCX-39-97, July 30, 1997, p. 2 – http://www.house.gov/jct/x-39-97.pdf.

[49]In 2000, the fifth year after the 1997 capital-gains rate reduction, the technology stock "bubble" burst causing an unforeseen decline in the stock market, which reduced capital-gain transactions substantially.

[50]Treasury Department, Office of Tax Policy, "Long-Term Capital Gains and Taxes Paid on Long-Term Capital Gains, 1977-2002" – http://www.treas.gov/offices/tax-policy/library/capgain2-2004.pdf. Actual capital-gain revenues increased by $10.8 billion in 1997, $11.0 billion in 1998, $10.8 billion in 1999, and $20.1 billion in 2000.

Current data indicate that the 2003 reduction in the capital-gains tax rate to the current 15 percent is producing similar dynamic results.[51] According to CBO estimates, the government's static analysis underestimated capital gains revenues by $5 billion in 2003, $16 billion in 2004, and $21 billion in 2005.[52] The resulting three-year $42 billion underestimate significantly exceeds both the JCT's five-year estimated loss of $13.4 billion and 10-year estimated loss of $22.4 billion.[53]

Moreover, in a recent Dear Colleague letter, Senate Finance Committee Chairman Grassley pointed out: "In its 2004 baseline, CBO projected that the reduced tax rate on capital gains caused a 14.9 percent increase in capital gains realizations between 2002 and 2004. With the new information on realizations through 2003 and preliminary data through 2004, CBO adjusted its January 2006 baseline because it now estimates 'that the tax reductions in [Jobs and Growth Tax Relief Reconciliation Act of 2003] caused gains to increase by 18.0 percent between 2002 and 2004.' So, according to the CBO, the impact of lower tax rates on capital gains realizations was more than 20 percent higher than expected."[54] Thus, while the static revenue estimates predicted sizeable losses in federal tax revenues, the dynamic effects of these changes in tax policy *have resulted in substantial increases in economic activity that have produced revenue gains for the federal government*.

These recent results underscore the reality that for taxes like the death tax, which have substantial adverse effects on economic growth, static revenue estimates provide only a partial picture. A complete assessment must include the dynamic effects of repealing the tax. Accordingly, the limitations of static estimates should not bar Congress from enacting the sound tax policy of permanently repealing the death tax, especially when the estimates for resulting economic growth are so compelling.

While the 2001 tax bill was an important victory, the repeal of the death tax cannot reach its full economic potential unless it is made permanent. In the words of one economist, "The common prosperity can never be promoted by penalizing people's efforts to be enterprising and to create wealth, for that [common] prosperity is founded on such efforts."[55] Studies have shown that a permanent repeal would allow the billions of dollars currently spent on efforts to avoid the death tax to be put to efficient use in the economy, and the result would be substantial gains in employment, wages, and economic growth. At a time when there are concerns about sustaining

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In contrast, the JCT estimated that the 1997 capital-gains rate reduction would increase revenues by $1.3 billion in 1997, $6.4 billion in 1998, and $171 million in 1999, with a revenue loss of $3.0 billion in 2000. JCT, JCX-39-97. See also, Stephen Moore and Phil Kerpen, "A Capital Gains Tax Cut: The Key to Economic Recovery," Institute for Policy Innovation, Policy Report 164, October 2001, pp. 4-6 – http://www.ipi.org/.

[51] Sections 301 of the Jobs and Growth Tax Relief Reconciliation Act of 2003, H.R. 2, 108th Congress, 2d Session, Public Law 108-27, May 28, 2003.

[52] CBO, "The Budget and Economic Outlook: Fiscal Years 2005-2014," Table 4-4, January 2004 – http://www.cbo.gov/ftpdocs/49xx/doc4985/01-26-BudgetOutlook-EntireReport.pdf; CBO, "The Budget and Economic Outlook: Fiscal Years 2007-2016, Table 4-4, January 2006 – http://www.cbo.gov/ftpdocs/70xx/doc7027/01-26-BudgetOutlook.pdf.

[53] JCT, "Estimated Budget Effects of the Conference Agreement for H.R. 2, the 'Jobs and Growth Tax Relief Reconciliation Act of 2003,'" JCX-55-03, May 22, 2003 – http://www.house.gov/jct/x-55-03.pdf.

[54] Senate Finance Committee Chairman Grassley, "CBO Can't Explain Half of the Growth in Capital Gains Realizations, but Reduced Tax Rates had a Bigger Impact than Expected," Dear Colleague Letter, March 1, 2006.

[55] Wagner, p. 41.

the past 18 quarters of economic expansion,[56] Congress should not disregard the real potential that a permanent repeal holds for continuing that record of growth – and possibly accelerating it.

Bill Provisions

The Death Tax Repeal Permanency Act of 2005 eliminates the sunset provision in EGTRRA, making the repeal of the death tax in 2010 permanent.

Revenue Estimate

When H.R.8 was considered by the House last year, the JCT estimated that the bill would result in a revenue loss of $9 billion over 5 years and $290 billion over 10 years.[57] As noted above, however, that estimate primarily reflects the estimated tax revenues that the government will no longer receive without the death tax, and it does not include increased tax revenues that would likely result from increased economic growth due to the repeal of the tax.

Administration Position

For the House's consideration of H.R. 8, the Administration issued the following Statement of Administration Policy on April 13, 2005:

> "The Administration strongly supports House passage of H.R. 8. The Administration is pleased that the House is acting now to make an important part of the President's tax relief plan permanent.
>
> "The Economic Growth and Tax Relief Reconciliation Act of 2001 provided well-timed and much needed tax relief to the American people, shortening the recession that had just begun and strengthening the foundation for a lasting recovery. Key elements of this relief included: a reduction in income tax rates, including a new low 10-percent rate; an increase in the child tax credit from $500 to $1,000 per child; a reduction in the marriage penalty; and elimination of the unfair death tax.
>
> "Eliminating the death tax is a matter of basic fairness. The death tax results in the double taxation of many family assets while hurting the source of most new jobs in this country – America's small businesses and farms. Unfortunately, the provision of the 2001 Act to repeal the death tax expires at the end of 2010, creating significant

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[56] Bureau of Economic Affairs, "Gross Domestic Product: First Quarter 2006 (Advance)," BEA 06-17, April 28, 2006, Table 1 – http://www.bea.gov/bea/newsrelarchive/2006/gdp106a.pdf.

[57] JCT, "Estimated Revenue Effects of H.R. 8, the "Death Tax Repeal Permanency Act of 2005," JCX-20-05, April 13, 2005 – http://www.house.gov/jct/x-20-05.pdf.

uncertainty for family estate planning. Permanent elimination of the death tax today would relieve thousands of family businesses, farms, and ranches of its excessive and unfair costs. The permanent repeal of the death tax would mean that many more family businesses would be preserved and could thrive as a source of continuing job creation and economic growth.

"The time to fix this problem is now, so American families, small businesses, and farmers can organize their estates without worrying about whether their plans will be jeopardized by a reemergence of the death tax. Making the repeal permanent will ensure that Americans can save for their children's education, undertake new business ventures, plan for retirement, budget for charitable contributions, and plan for the transfer of family businesses with the knowledge that Congress has acted to eliminate uncertainty.

"The Administration urges quick action in Congress to make the elimination of the death tax permanent."

Possible Amendments

Senator Kyl may offer an alternative amendment. Other amendments, including an alternative Democrat proposal, are possible.